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Report of the Partnerships and Limited Liability Companies Committee

REPORT ON LEGAL OPINIONS CONCERNING CALIFORNIA LIMITED LIABILITY COMPANIES

-- February 2000 --

By the Partnerships and Limited Liability Companies Committee
of the Business Law Section of the State Bar of California

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REPORT ON LEGAL OPINIONS

CONCERNING CALIFORNIA LIMITED LIABILITY COMPANIES

(February 2000)

By the
Partnerships and Limited Liability Companies Committee
of the Business Law Section
of the State Bar of California

This Report is a commentary on written opinions concerning California limited liability companies by the Partnerships and Limited Liability Companies Committee of the Business Law Section of the State Bar of California.

Since the enactment of the Beverly-Killea Limited Liability Company Act[1] (the "LLC Act") in 1994, the formation of limited liability companies in California and their use in business transactions have proliferated. Practitioners increasingly are requesting and rendering legal opinions concerning California limited liability companies. Yet existing published reports on legal opinions, including the Committee's Report on Legal Opinions Concerning California Partnerships issued in February, 1998 (the "Partnerships Report"),[2] do not directly address the issues that arise when the entity being opined upon is a limited liability company. The purpose of this Report is to fill this void and provide guidance to practitioners in requesting and rendering legal opinions regarding limited liability companies.

This Report is limited to consideration of those issues that are unique to legal opinions given with respect to California limited liability companies. Like the Partnerships Report, this Report is not a general treatment on opinion letters. In that regard, readers are referred to the 1989 Report of the Committee on Corporations of the Business Law Section of the State Bar of California Regarding Legal Opinions in Business Transactions (August 1989) (the "Corporations Report"); the Third-Party Legal Opinion Report including the Legal Opinion Accord (the "Accord") of the Section of Business Law American Bar Association (1991) (the "ABA Report"); the Business Law Section of the State Bar of California Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law (May 1992) (the "California Report"); the TriBar Opinion Committee Report on Third-Party "Closing" Opinions, 53 Bus. Law 591 (February 1998) ("TriBar II Report"); and the Section of Business Law American Bar Association Report on Legal

Opinion Principles, 53 Bus. Law 831 (May 1998).[3]

I.
ACKNOWLEDGMENTS

This Report is the result of a project of the Partnerships and Limited Liability Companies Committee of the Business Law Section of the State Bar of California. The Committee is made up of California practitioners who as a regular part of their practice render and receive legal opinions concerning California limited liability companies in business transactions. This Report is the result of the efforts of the following individuals:

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The views set forth in this Report reflect a consensus among the members of the Committee but do not necessarily reflect the positions of individual members or their respective firms or organizations. This Report has not been considered or approved by the State Bar of California or by its Business Law Section.

II.
DISTINCTIONS BETWEEN LIMITED LIABILITY COMPANIES AND OTHER BUSINESS ENTITIES

Prior to the issuance of the Partnerships Report, the major reports dealing with giving and receiving opinions in business transactions primarily addressed issues relating to the representation of corporations. A primary function of the Partnerships Report was to identify the differences between partnerships and corporations and how such differences affect the form and substance of opinions relating to such entities.

Limited liability companies, in turn, have many similarities with other business entities, especially limited partnerships, but also differ from other business entities in significant ways that influence opinion practice.

As is discussed in further detail below, a limited liability company, like a corporation and a limited partnership, but unlike a general partnership, can only be formed by complying with statutory filing requirements. A limited liability company cannot be formed at will. In determining the formation and existence of a California limited liability company, therefore, counsel must investigate specific filings with the California Secretary of State required by the LLC Act.

The LLC Act, unlike the statutes governing corporations and partnerships, restricts limited liability companies from engaging in professional services. As discussed below, this imposes on counsel a unique burden in opining upon the power of a limited liability company to conduct the business in which it is engaged.

The LLC Act allows a flexibility in the management of limited liability companies broader than that available to other business entities. The LLC Act allows a limited liability company to be managed by its members in a manner similar to a general partnership, by managers in a manner similar to a limited partnership, by officers appointed by an elected board of managers in a manner similar to a corporation, or by any combination of the foregoing. This advantageous flexibility imposes upon counsel an added burden in determining who has the authority to act on behalf of a limited liability company.

These and other distinctions highlight the need to separately address and consider issues relating to the rendering of opinions regarding limited liability companies.

III.
OPINIONS

This part of the Report addresses terminology commonly used in opinions relating to California limited liability companies as entities and to their authority to transact business. The Report assumes that the opinion recipient is a potential lender to a limited liability company, a potential member, or a potential purchaser of a limited liability company's business or assets. The Report identifies the typical concerns of such an opinion recipient, suggests language appropriate for addressing those concerns, identifies and distinguishes any different corporate or partnership vocabulary used to address the same concerns, and identifies the research and investigation counsel normally should perform in rendering the relevant opinion.

A. Status of the Limited Liability Company.

Opinion recipients normally want to know the type of entity with which they are dealing and that the entity is a legal person. An opinion that addresses this concern is typically referred to as a "status opinion."

I. Domestic Limited Liability Companies.

Recommended Wording of Status Opinion. The Committee recommends the following wording for a status opinion for a limited liability company:

> [Name of entity] (the "Company") is a duly formed limited liability company and is existing in good standing under the laws of the State of California.

Contrast with Corporate and Partnership Status Opinion. The recommended wording includes the phrases "duly formed," "existing," and "in good standing," and is virtually identical to that suggested by the Partnerships Report for use in connection with status opinions regarding limited partnerships.[4] The wording excludes the phrase "duly organized," recommended in the Corporations Report in connection with status opinions regarding corporations. The wording also eliminates the term "validly," used to modify the term "existing" in the formulation of the status opinion for corporations recommended by the Corporations Report.

"Duly Formed" and "Duly Organized." With respect to a corporation, the phrase "duly formed and organized" means that the corporation has filed certain documents (articles of incorporation) with the Secretary of State and has taken certain steps relating to its internal organization, as required by statute.[5] The phrase "duly formed" with respect to a limited partnership means only that the limited partnership has filed a certificate of limited partnership with the Secretary of State.[6] The LLC Act's treatment of the formation of limited liability companies is virtually identical to that of the California Revised Limited Partnership Act's treatment of the formation of limited partnerships.[7] The LLC Act specifies that "[i]n order to form a limited liability company, one or more persons shall execute and file articles of organization with. ..the Secretary of State and. The members shall have entered into an operating agreement."[8] The LLC Act expressly provides, however, that "[f]or all purposes, a certified copy of the articles of organization duly certified by the Secretary of State is conclusive evidence of the formation of the limited liability company" [emphasis added].[9] Thus, an opinion that a limited liability company is "duly formed" means *only* that articles of organization for the limited liability company have been filed with the Secretary of State with respect to the limited liability company.

The LLC Act does not use the term "organized" with respect to limited liability companies and, therefore, as with limited partnerships, the phrase "duly organized" has no additional meaning with respect to a limited liability companies and is not recommended.[10] If used, the phrase should be understood to mean only that the limited liability company is "duly formed."

"Existing." The phrase "existing" with respect to a corporation means that a duly formed corporation has not dissolved or ceased to exist by reason of an election to dissolve, a merger or the operation of a limitation on the duration of its existence in its articles of incorporation.[11] A limited liability company is like a corporation in that a limited liability company's existence is terminated as a matter of official record only when the limited liability company files a certificate of cancellation or merges out of existence. A limited liability company is like a general or limited partnership, however, in that dissolution, by itself, does not affect the existence of a limited liability company. The LLC Act specifies that a "limited liability company that is dissolved nevertheless continues to exist for the purpose of winding up its affairs, prosecuting and defending actions...disposing of...its property, and collecting and dividing its assets."[12] As with limited partnerships, therefore, dissolution does not terminate the existence of a limited liability company[13] and, subject to the discussion in the following paragraph, an opinion that a limited liability is existing means only that a duly formed limited liability company has not filed a certificate of cancellation of its articles or organization or been merged out of existence. On the other hand, it is the consensus of the Committee that, in requesting a status opinion, the recipient reasonably may expect to be advised whether a certificate of dissolution for the

limited liability company has been filed. Therefore, even though dissolution technically should not be grounds for taking an exception to the limited liability company's existence, the opinion giver nonetheless should advise the recipient if dissolution proceedings have commenced.[14]

As noted, the LLC Act provides that in order to form a limited liability company, the members are required to enter into an operating agreement, whether written or oral.[15] Although the LLC Act provides that the existence of a limited liability company begins upon the filing of its articles of organization, it also provides that, whereas certified articles of organization are *conclusive* evidence of the limited liability company's formation, they are only *prima facie* evidence of the limited liability company's existence.[16] Therefore, it is the consensus of the Committee that an opinion that a limited liability company is in existence (as opposed to the opinion that it has been formed) includes the additional element that the members have entered into an operating agreement.

The Corporations Report applies the word "validly" with respect to a corporation's existence to distinguish a "de facto" corporation from a "de jure" corporation.[17] There are no cases that indicate that the de facto/de jure distinction applies to limited liability companies and the term "validly" has no additional meaning when used in connection with the existence of a limited liability company.

"In Good Standing." With respect to a corporation, the phrase "in good standing" means that the corporation's charter has not been suspended or forfeited and the opinion with respect to a corporation may be based solely on a certificate of good standing from the Secretary of State.[18] With respect to a limited liability company, the Secretary of State will issue a certificate of good standing if the limited liability company has not filed a certificate of cancellation or been merged out of existence. A limited liability company files a certificate of cancellation when it has wound up its affairs.[19] Although a limited liability company must pay an annual franchise tax equal to the minimum franchise tax payable by corporations and an annual fee based on its total income[20] and must obtain a tax clearance certificate from the Franchise Board before the Secretary of State will file a certificate of cancellation,[21] in contrast to corporations, there are no provisions for the suspension or forfeiture of the limited liability company's charter or any of its rights or powers in the event the limited liability company fails to pay the tax or fee. Thus, an opinion that a limited liability company is "in good standing" only means only that a duly formed limited liability company has not filed a certificate of cancellation of its articles or organization or been merged out of existence.

A "good standing" opinion may be based solely on a certificate of status issued by the Secretary of State or solely on a copy of the certificate of the limited liability company's articles of organization certified by the Secretary of State with all subsequent filings, none of which is a certificate of cancellation or merger. The opinion does not require any other investigation or research once counsel has concluded that the entity has not filed a certificate of cancellation or merger, nor does it imply that such investigation or research has been performed.

Elements of the Status Opinion. The consensus of the Committee is that the elements of a status opinion for a limited liability company are as follows:

> (a) Articles of organization have been filed with the California Secretary of State (but not that the articles are free from misstatement).
>
> (b) The members have entered into an operating agreement (which need not be in writing).

(c) No certificate of cancellation has been filed with respect to the limited liability company.

(d) The limited liability company has not merged into another entity.

Investigation. Counsel ordinarily confirms the elements of a status opinion by (i) reviewing a copy of the articles of organization certified by the Secretary of State with all amendments, (ii) reviewing a copy of the signed operating agreement, if there is one, and (iii) obtaining the assurance of the manager or one or more managers, if the limited liability company is manager-managed, or one or more members if the limited liability company is member-managed, that the copies of the articles and the operating agreement are true and complete, with all amendments.[22] If there is no written operating agreement, counsel also will want to obtain the assurance of one or more managers or members, as applicable, that the members have entered into an oral operating agreement and that the limited liability company in fact has one or more members (ordinarily the written operating agreement will disclose this fact)[23]

Assumptions. In rendering a status opinion, unless the parties agree otherwise, the opinion giver is entitled to rely on the following assumptions. These assumptions are in addition to other assumptions, such as the validity of signatures, which apply in other contexts as well. These assumptions are not normally expressly stated in the written opinion. These assumptions are:

(a) Any individual or entity constituting a manager, member, officer or otherwise acting on behalf of the limited liability company has the legal capacity or entity power and authority to carry on the business of the limited liability company in his, her or its individual capacity.[24]

(b) The members have the legal capacity or entity power and authority to be members of the limited liability company.

Misstatements in the Articles. The consensus among the Committee is that a misstatement in the articles of organization of a limited liability company does not affect the status of a limited liability company, notwithstanding the requirement of Section 17051 of the LLC Act that the articles set forth certain matters. First, as noted, Section 17050(c) of the LLC Act provides that a certified copy of the articles is conclusive evidence of the formation of a limited partnership and prima facie evidence of its existence. Second, Section 17054(e) of the LLC Act imposes liability on any manager for misstatements in the articles, which appears to be the only legal consequence of the misstatement.

Nonetheless, since the articles of organization of a limited liability company, in contrast to equivalent formation documents required of corporations or limited partnerships (which have far less flexibility in management than limited liability companies), require that the limited liability company specify whether it is managed by a single manager, more than one manager, or the members,[25] counsel should take special care to confirm that there are no discrepancies between the articles, the operating agreement and any certifications of the client on these matters. Although such a discrepancy should not affect the formation or existence of the limited liability company, it almost certain will impact any opinion regarding the power and authority of the limited liability company and/or of the individuals or entities signing on its behalf. In any event, as a matter of professional responsibility to the client, counsel normally will call the discrepancy or any other misstatement in the articles to the client's attention so the mistake can be corrected before an

opinion is rendered.

2. Registration of Foreign Limited Liability Companies.

California counsel are occasionally asked to render an opinion that a foreign limited liability company is qualified to do business in California. It should be noted that, as is the case with foreign corporations and limited partnerships, the LLC Act only requires a foreign limited partnership to register to transact intrastate business.[26] A limited liability company that is required to register but has not done so must register before it may maintain an action, and failure to register subjects it to penalties of up to $10,000.[27]

Recommended Wording of Due Qualification Opinion. The Committee recommends the following wording of the due qualification opinion:

> The Company is duly registered to transact intrastate business in California as a foreign limited liability company and is in good standing in California.

Contrast with Corporate and Partnership Due Qualification Opinion. The Committee's recommended formulation is virtually identical to the Partnership Report's recommended formulation for limited partnerships which, in turn, is similar to a common corporate formulation, but substitutes the phrase "registered to transact intrastate business" for "qualified to do business." This is to reflect the language used in Section 17451 of the LLC Act, which pertains to registration of foreign limited partnerships.

Investigation. Opinions as to foreign registration can be based solely on a certificate of registration issued by the Secretary of State.

B. Power to Conduct Business.

Opinion recipients normally want to know that the business of the limited liability company is one that can lawfully be carried on by the limited liability company as a matter of limited liability company law. While opinion recipients may also want to know whether other legal restrictions, such as industry regulations,[28] affect the business of the limited liability company, such concerns are normally addressed in a separate opinion, if at all, and not in the "power-to-conduct-business" opinion.

Recommended Wording of Power-to-Conduct-Business Opinion. The Committee recommends the following wording for the power-to-conduct-business opinion. The Company has the limited liability company power [and authority] to [enter into and perform the agreement, to][29] own its properties and assets and to carry on its business [as it is currently being conducted].

Contrast with Corporate and Partnership Power-to-Conduct-Business Opinion. The Committee's recommended formulation is similar to a common corporate and partnership formulation, but substitutes the word or phrase "limited liability company" for either "corporate" or "[limited] partnership,"[30] as the case may be.

"Power [and Authority]." With regard to power [and authority], limited liability companies have a number of characteristics in common with corporations and limited partnerships. For example, limited liability companies are similar to corporations and limited partnerships with respect to their authorized activities. The

General Corporation Law affirmatively states that a corporation "may engage in any business activity" with certain specific exceptions[31] and limited partnerships "may carry on any business that a partnership without limited partners may carry on" with certain specified exceptions.[32] Similarly, the LLC Act affirmatively states that a limited liability company "may engage in any lawful business activity" with certain exceptions:[33]

As with the articles of incorporation of a corporation, the articles of organization of a limited liability company typically do not restrict the power or business purpose of the limited liability company.[34] In fact, the LLC Act[35], in a manner equivalent to the General Corporation Law,[36] mandates that the articles of organization contain a broad statement of purpose.[37] On the other hand, as with the partnership agreement of a partnership, it is common for an operating agreement of a limited liability company to restrict the business purpose and powers of the limited liability company.

With respect to a corporation, the use of the word "corporate" and, with respect to a partnership, the use of the word "partnership" or the phrase "limited partnership," before "power" serves to limit the opinion to the effect of the enabling statute and formation documents applicable to the particular business entity and to preclude any interpretation that the corporation or the partnership, as the case may be, has any approvals or authorizations under other statutes, such as those that regulate particular industries or activities. With respect to a limited liability company, the use of the phrase "limited liability company" serves the same function, which is to clarify that counsel is opining only as to general limited liability company power and not as to regulatory authorizations necessary for the limited liability company to conduct its business.[38]

Addition of the phrase "and authority" does not affect the meaning of the opinion, although the phrase "power and authority" is commonly requested and given in opinion practice. In particular, the term "authority" in this context does not imply that the execution, delivery and performance of the subject agreement has been authorized by all necessary limited liability company action (e.g., the affirmative vote of the members). The "power and authority" opinion addresses whether the limited liability company generally has the power to conduct its business or engage in the subject transaction, not ***who*** may act on behalf of the limited liability company in entering into the transaction. That instead is an element of the "due authorization" opinion.

Exclusion of "Current Conduct" Language. The Committee acknowledges that past practice with respect to corporations and partnerships has been to include the phrase "as it is currently being conducted" in the power-to-conduct-business opinion. Based on evolving standards of opinion practice, however, the Committee concluded in the Partnerships Report that it is inappropriate for an opinion recipient to request such language with respect to partnerships.[39] The Committee is of the view that it is equally inappropriate with respect to limited liability companies. While counsel may rely on a certificate of the client for a description of the limited liability company's business, it is the unusual situation where a certificate is comprehensive enough to describe all the ways in which the business of the limited liability company is being conducted. Requesting such language from counsel places an investigatory burden on counsel that is out of proportion to any value to be gained from the opinion. Moreover, because the opinion is so fact-sensitive and relies necessarily on the certificate of the client rather than the independent investigation of counsel, an opinion recipient cannot reasonably rely on such an opinion to any material extent.

Elements of the Power-to-Conduct-Business Opinion. The consensus of the Committee is that the elements of the power-to-conduct business opinion for a limited liability company are as follows:

1. The limited liability company's business is permitted under the LLC Act.

2. The limited liability company's business is within the scope of the purpose of the limited liability company.

3. The members or managers, as applicable, have the power to conduct the business of the limited liability company in their individual capacities (although this is normally assumed, as noted below).

Investigation. Counsel may determine that a limited liability company has the limited liability company power and authority to conduct its business by reviewing a copy of the articles of organization certified by the Secretary of State, and a certified[40] copy of the operating agreement as amended, including the sections that deal with (i) the purpose of the limited liability company, (ii) specific authorizations of one or more of the members, (iii) limitations on the authority of the members and managers, and (iv) voting or approval rights of non-managing members.

Assumptions. In rendering a power-to-conduct-business opinion, unless the parties agree otherwise, the opinion giver is entitled to rely on the following implicit assumptions, which are not normally expressly stated in the opinion, in addition to other assumptions, such as the validity of signatures, which apply in other contexts as well:[41]

1. The limited liability company is not engaged in the banking, insurance or trust company business.

2. Managers or members, as applicable, who are natural persons have the legal capacity to conduct limited liability company business in their individual capacities.

3. Managers or members, as applicable, that are entities have the power and authority to conduct limited liability company business in their individual capacities.[42]

Exception for Limited Liability Companies in Dissolution. If a limited liability company has dissolved, its power is limited to actions that are appropriate to the winding-up process.[43] Absent an exception in the written opinion, a power-to-conduct-business opinion with respect to a dissolved limited liability company means that the actions of the limited liability company are consistent with the winding-up process. Such a conclusion normally depends on knowledge of facts beyond the capacity of counsel to ascertain. To establish the necessary facts, a certificate of the client would have to describe all of the actions of the limited liability company without resorting to a conclusory statement that all of the actions are part of the winding up process. Accordingly, when a limited liability company is in dissolution, counsel normally excludes any opinion concerning the winding-up process. Such an exclusion may be worded as follows:

We note that the Company has dissolved. We render no opinion as to whether the present conduct of the Company's business is consistent with the limitation on the authority of the members or the manager(s), as applicable, to those actions that are necessary to wind up the Company's affairs, prosecute and defend actions in order to collect and discharge obligations, dispose of and convey its property and collect and divide its assets.

The Special Problem of Professional Services and Limited Liability Companies. When asked to render an opinion regarding the power and authority of a limited liability company to carry on its business, the opinion giver faces an issue unique to limited liability companies. The statute enacting the LLC Act (Stats. 1994, Chapter 1200) originally contained an uncodified Section 93 stating that nothing in the LLC Act was to be construed to permit limited liability companies to render "professional services" in California. This provision recently was codified and is now contained in Section 17375 of the LLC Act which states in full that: "Nothing in this title shall be construed to permit a domestic or foreign limited liability company to render professional services, as defined in subdivision (a) of Section 13401, in this state." Cal. Corp. Code § 13401 (a) defines professional services as "any type of professional services that may be lawfully rendered only pursuant to a license, certificate or registration authorized by the Business & Professions Code or the Chiropractic Act."

Arguably, the restrictions of Section 17375 are, as they relate to the power and authority of the limited liability company to conduct its business, no different than any other requirement that a business obtain required governmental licenses and permits. Since, as discussed above, the power and authority opinion is not intended to address such governmental approvals or authorizations, it stands to reason that the power and authority opinion is not intended to address whether the limited liability company is rendering professional services inconsistent with Section 17375.

It is the consensus of the Committee, however, that, because the limitations on limited liability companies rendering professional services are contained in the LLC Act itself and because, as noted above, an element of the power-to-conduct-business opinion is that the limited liability company's business is permitted under the LLC Act, it is reasonable that, absent an express qualification to the contrary, the opinion recipient will expect that the power-to-conduct-business opinion will encompass the conclusion that the limited liability company is not rendering "professional services." Furthermore, in the absence of any authority on the matter or any certainty as to how a court might rule on the subject, the consensus of the Committee is that it probably is imprudent for counsel rendering the power-to-conduct business opinion to assume that the provisions of Section 17375 have no relevance to the power-to-conduct-business opinion.

The restrictions of Section 17375 are analogous to Cal. Corp. Code Section 17002, which prohibits limited liability companies from engaging in the banking, insurance or trust company businesses. Because of the nature of the banking, insurance and trust company businesses, it would be rare for a client, its counsel or, for that matter, the other party to a transaction to be mistaken as to whether the limited liability company is engaged in such activities. The Corporations Report, the Partnerships Report and this Report, therefore, all provide that the power and authority opinion is supported by the unexpressed assumption that the applicable entity is not engaged in those businesses. In contrast, because of the breadth of the professional services referenced in Section 17375, in many instances it may be both more potentially likely that a limited liability company is inadvertently engaged in rendering such services and more difficult to ascertain whether the activities of the limited liability company require licensing. It is the consensus of the Committee, therefore, that it is inappropriate to support the power-to-conduct business opinion with the unexpressed assumption that the limited liability company is not engaged in rendering such professional services.

There may be many instances where counsel is sufficiently familiar with the business of the limited liability company that counsel is comfortable providing a power-to-conduct-business opinion that implicitly includes the element that the limited liability company is not engaged in professional services for purposes of Section 17375 without further qualification.[44] This may not be the case in other instances, however. Although a manager's or member's certificate to counsel can attempt to list its business activities, the determination of whether a particular business activity requires licensing under the Business and Professions Code, ultimately requires a legal conclusion. Therefore, an opinion giver should not rely on

conclusory statements by a manager or member that a limited liability company is not rendering professional services. On the other hand, it is not only impractical to obtain a complete list of a client's activities (see the discussion regarding "Current Conduct" above), but also unreasonable to presume that an opinion giver can be expected to determine, without an undue expenditure of time, that each listed activity is outside of licensing requirements under the California Business and Professions Code.

The consensus of the Committee is that, if the opinion giver is uncomfortable providing an unqualified opinion that the limited liability company does not render professional services, at least one of two approaches may be taken for the opinion giver to act prudently and to meet the reasonable expectations of the opinion recipient without placing undue demands on counsel.

First, counsel may obtain a certificate from the manager(s) or members of the limited liability company setting forth the ***principle*** business activities of the company. If, based on the certificate, counsel is comfortable concluding that such activities do not fall within the restrictions of Section 93, the opinion giver may provide an express qualification along the following lines:

> We advise you that, pursuant to Section 17375 of the Act, a limited liability company generally is not permitted to render professional services, as defined in Cal. Corp. Code §13401(a). In rendering the opinion set forth in paragraph _____ [the power-to-conduct business opinion], we have relied exclusively upon the [Certificate of _____] in determining the principle business activities of the Company and have concluded that such activities do not constitute the rendering of professional services. We have not, however, engaged in any independent investigation of the scope of the business activities of the Company and render no opinion as to the compliance of any business activities of the Company that are not described in the [Certificate of _____] with the provisions of the Act.

Alternatively, the opinion giver may provide an ***express*** assumption to address this issue, such as the following:

> In rendering the opinion set forth in paragraph _____ [the power-to-conduct-business opinion], we have assumed that the Company is not engaged in rendering "professional services," as that term is defined in Cal. Corp. Code § 13401(a). During the course of our representation of the Company, no information has come to our attention that renders this assumption invalid. We have not, however, undertaken any independent investigation to determine the accuracy of this assumption.

C. Power and Authority to Enter Into the Agreement.

A variation on the power-to-conduct-business opinion is the power-to-enter-into-the-agreement opinion. Opinion recipients normally want to know that the limited liability company can lawfully enter into the transaction that is the subject of the opinion as a matter of limited liability company law. The commentary and analysis set forth above with respect to the power-to-conduct business opinion applies equally to the power-to-enter-into-the agreement opinion, except that, as noted below, the power-to-enter-into-the-agreement opinion, standing alone, may alleviate some of the issues regarding limited liability companies rendering professional services.

Recommended Wording of Power-to-Enter-Into-the-Agreement Opinion. The Committee recommends the following wording of the power-to-enter-into-the agreement opinion:

> The Company has the limited liability company power [and authority] to enter into and perform the agreement.

Opinions with respect to the power to carry on business and the power to enter into an agreement may be combined as follows:

> The Company has the limited liability company power and authority to enter into and perform the agreement, to own its properties and assets and to carry on its business [as it is currently being conducted].

Contrast with Corporate and Partnership Power-to-Enter-Into-the-Agreement Opinion. The Committee's recommended formulation is similar to a common corporate and partnership formulation but substitutes the word or phrase "limited liability company" for "corporate" or "[limited] partnership"[45] as the case may be.

With respect to a corporation, the power-to-enter-into-the-agreement opinion means that the acts contemplated by the agreement would not be *ultra vires*.[46] While the phrase *ultra vires* is not commonly associated with limited liability companies, the concern that a limited liability company's charter documents may restrict the limited liability company's ability to enter into a particular agreement is nonetheless valid.

Elements of the Power-to-Enter-into-the-Agreement Opinion. The consensus of the Committee is that the elements of the power-to-enter-into-the-agreement opinion for a limited liability company are as follows:

> 1. The transaction and each of its components are permitted under the LLC Act.[47]
>
> 2. The transaction and each of its components are within the scope of the purpose of the limited liability company.
>
> 3. If the limited liability company has dissolved, the transaction is necessary to wind up the Company's affairs, prosecute and defend actions in order to collect and discharge obligations, dispose of and convey its property, and collect and divide its assets.[48]

Investigation. Counsel may determine that a limited liability company has the power and authority to enter into the agreement(s) relating to the subject transaction by reviewing a copy of the articles of organization certified by the Secretary of State, and a certified[49] copy of the operating agreement as amended, including the sections that deal with (i) the purpose of the limited liability company, (ii) specific authorizations of one or more of the members, (iii) limitations on the authority of the members and the managers, and (iv) voting or approval rights of non-managing members.

In many situations, the proposed transaction does not fit squarely within the express purpose of the

limited liability company or is not expressly included in the various authorizations that may be included in the operating agreement. Depending on the degree of uncertainty involved, counsel may in some cases be justified in relying on a certificate of one or more of the managers, managing members or members, as the case may be, which states the intentions and understanding of the parties in forming the limited liability company and defining its scope. It is not unusual for counsel to require the members to amend the operating agreement, or to execute a resolution, certificate or waiver that has the effect of amending the operating agreement, before counsel will render a power-to-enter-into-the-agreement opinion.

Where the limited liability company has dissolved, counsel must also determine whether the proposed transaction is consistent with the limitations on the powers of the managers, managing members or members, as the case may be, to the winding up of the limited liability company affairs and completion of unfinished business. In most cases, the determination will be relatively easy. For example, the sale of limited liability company property is consistent with winding up limited liability company affairs while a refinancing of limited liability company debt that is not otherwise due and payable would not normally be consistent with winding up limited liability company affairs.**50**

Assumptions. In rendering a power-to-enter-into-the-agreement opinion, unless the parties agree otherwise, the opinion giver, in addition to relying on other assumptions, such as the validity of signatures, which apply in other contexts as well, is entitled to rely on the following assumption which is not normally expressly stated in the written opinion:**51**

> In cases where the limited liability company has dissolved, the sale of any given limited liability company asset is "necessary" or "appropriate" to wind up limited liability company affairs within the meaning of Section 17354 of the LLC Act.

D. Due Authorization, Execution and Delivery.

Assuming that a limited liability company has the authority to enter into a proposed transaction, the opinion recipient will still want to know that the transaction has been authorized by any necessary vote of the managers or members, and that the transaction documents have been duly executed and delivered by the appropriate persons on behalf of the limited liability company.

Recommended Wording of the Due Authorization, Execution and Delivery Opinion. The Committee recommends the following wording of the due authorization, execution and delivery opinion:

> The [agreement] has been duly authorized by all necessary limited liability company action on the part of the Company and has been duly executed and delivered by the Company.

1. Due Authorization of the Agreement

(a) Meaning

"Due authorization" means that the limited liability company's members, managers, officers and/or committee of members or managers have taken all actions required to authorize the execution and delivery of the agreement and performance by the Company of its obligations thereunder, to the extent and in such a

manner required by (i) the LLC Act, (ii) the Company's articles of organization, (iii) the operating agreement of the Company, and (iv) separate resolutions of members and/or managers, as appropriate.

The phrase "duly authorized by all necessary limited liability company action on the part of the Company" may be preferable to "duly authorized" alone since the latter may imply authorization by a governmental regulatory body or by another party whose consent may be required. The "duly authorized" opinion does not encompass an opinion that the members, managers or officers of a company, in approving a transaction or agreement, are in compliance with their fiduciary duties. Since fiduciary questions are largely factual and subjective in nature, coverage would not normally be appropriate in the legal opinion, and a lawyer's assumption about compliance with fiduciary obligations is implicit in the "duly authorized" opinion. As a matter of prudence, however, lawyers may choose to expressly state an assumption where fiduciary issues are particularly sensitive.

(b) Elements of the Due-Authorization-of-the-Agreement Opinion

The consensus of the Committee is that the elements of the due-authorization-of-the-agreement opinion for a limited liability company are as follows:

> (1) The articles of organization and operating agreement do not restrict the power or authority of the officers, members or managers who are executing the transaction documents unless the restriction has been complied with or is waived.
>
> (2) The officers, members and/or managers, as applicable, have complied with any procedural requirements of the articles of organization, operating agreement, and any delegation of authority adopted by resolution of the managers or members.
>
> (3) There is no restriction in the LLC Act on the power of the members, managers or officers executing the transaction documents unless the restriction has been complied with or waived.

Voting Requirements of Members. Cal. Corp. Code § 17103 provides that the articles of organization or a written operating agreement may grant all or certain identified members or special class of members the right to vote separately or as a class on any matter. Except where the vote of a specified percentage of the members is required under paragraphs (b) and (c) of § 17103, voting by members may be on a *per capita* number, financial interest, class or any other basis. In the absence of voting provisions in the articles of organization or written operating agreement, the vote of a majority in interest of the members is sufficient with respect to all matters in which a vote is required, except that an amendment of the articles of organization or operating agreement or, under certain circumstances, a merger with another business entity,**52** require a unanimous vote. A "majority in interest of the members" means more than 50 percent of the interests of members in current profits of a limited liability company.**53**

(c) Investigation

The LLC Act provides great flexibility in the management of a limited liability company. In order to opine that an agreement or transaction is duly authorized, counsel must first determine whether the articles

of organization or operating agreement authorize or restrict the transaction. Second, counsel must determine whether the articles of organization and operating agreement require any specific action by the members or managers, such as a vote, to authorize the transaction and, if so, whether that vote has been taken. Third, counsel must determine whether any applicable provision of the LLC Act restricts the ability of the Company to enter into the transaction or requires a vote other than that set forth in the articles of organization or operating agreement.

Review of Articles. Counsel normally first reviews the articles of organization to determine whether the limited liability company is a member-managed or manager-managed LLC. Counsel should also determine whether the articles of organization include any provision limiting or restricting the business or powers of the Company, any limitation on the authority of the managers or members to bind the Company, or any provision requiring special approvals for certain types of transactions.

Review of Operating Agreement. Counsel normally reviews the operating agreement to determine whether the operating agreement specifically authorizes the contemplated transaction. Specific authorizations that relate to the operation of the business of the company are common. Counsel may conclude that the transaction is authorized in the operating agreement if the authorization is sufficiently clear and counsel determines, through receipt of a certificate of one or more members or managers, as appropriate, that all relevant conditions have been satisfied.

Review of Books and Records. If the limited liability company maintains a minute book or other records similar to a corporate minute book, counsel normally will review the minute book, especially to determine that the managers approving the agreement (assuming the Company is manager-managed) have been duly elected or appointed by the members. In the absence of a minute book, the operating agreement itself (including any amendments thereto), coupled with a certificate of the members and/or managers of the Company, typically evidence the election or appointment of the managers acting on behalf of the Company.

Separate Approval by the Members. Counsel normally obtains and reviews a separate authorization of the members under the following circumstances:

(1) The operating agreement does not authorize the transaction;

(2) The transaction is different from an authorization contained in the operating agreement in some material respects;

(3) The operating agreement affirmatively prohibits or restricts the transaction;

(4) The operating agreement or the LLC Act require a separate approval of the members; or

(5) In the case of a manager-managed limited liability company, the transaction is outside the scope of authority of the manager.

Approval by the Managers. Counsel normally obtains or reviews a separate authorization of the managers under the following circumstances:

(1) The Company has more than one manager;**54**

(2) The operating agreement does not authorize the transaction;

(3) The transaction is different from an authorization contained in the operating agreement in some material respects; or

(4) The operating agreement requires a separate approval of the managers.

Certificates. Counsel normally obtains and reviews a separate certificate of the members and/or managers of the Company[55] certifying:

(1) That the articles of organization and any written operating agreement of the Company, and any amendments thereto, reviewed and relied upon by the opinion giver, are true, complete and correct, and that such articles of organization and written operating agreement have not been amended, revoked or otherwise modified since the date of their execution;

(2) That copies of any company or member resolutions, consents or authorizations reviewed or relied upon by the opinion giver, are true, complete and correct, and such resolutions, consents or authorizations have not been amended, rescinded or revoked since the date adopted and are the only resolutions, consents or authorizations relating to the matters that are the subject matter of the opinion;

(3) That the Company's relevant resolutions, consents or authorizations were adopted in compliance with any procedural requirements set forth in the Company's articles of organization, any written operating agreement and the Act; and

(4) If applicable, that the managers or officers acting on behalf of the Company were duly appointed and incumbent in their offices at the time of all relevant actions and at all relevant times thereafter.

Assumptions. In rendering a due-authorization-of-the-agreement opinion, unless the parties agree otherwise, the opinion giver is entitled to rely on the following assumption, which is not normally expressly stated in the written opinion:

Any members or managers that are entities have taken whatever internal entity procedures (such as board or member or manager or partner approval) as are necessary to enable them to act on behalf of the Company.

Any opinion as to the due authorization of the representative of a member or manager that is an entity to enter into the agreement on behalf of the Company should be separately requested. Any such opinion is normally rendered, if at all, by the counsel that represents the manager or member.

The opinion giver is entitled to rely on other assumptions as well, noted elsewhere in this Report,

including the validity of signatures.

(d) Spousal Consent Not Required

In general, the consent of a member's spouse is not required with respect to any company transaction, even if that transaction could affect a membership interest that is community property. While a member may have an obligation to give prior notice to his or her spouse before disposing of a business or interest, failure to do so will not invalidate the transfer.[56]

2. Due Execution

"Duly executed" refers to the authorization of the officers, managers or members who have signed the documents on behalf of the Company, the validity of their signatures (often assumed elsewhere in the body of the opinion) and the incumbency of the person signing the agreement (often addressed in an incumbency certificate).

3. Due Delivery

"Duly delivered" means that the Company has delivered the agreement to the other party or parties to the transaction to create a binding contract. In order to give an opinion that a document has been duly delivered, counsel should be present at the delivery or be otherwise satisfied as to the due delivery.

IV.
CONCLUSION

Opinion practice remains more art than science. The purpose of this report has been to express the Committee's view regarding the meaning of various terms and the scope of particular opinions often requested and given in legal opinions concerning limited liability companies, to offer guidance regarding appropriate assumptions and due diligence in rendering such opinions, and otherwise to provide some general assistance to California lawyers in the preparation of such opinions. For the lawyer not regularly engaged in opinion practice, this commentary, when combined with the reports referenced in the preamble to this report, should provide a greater understanding of the procedures lawyers follow when requesting and rendering legal opinions. For the experienced business lawyer, the Committee has attempted to provide a readily available reference and checklist for issues and problems routinely encountered in rendering such opinions.

NOTES

1 CAL. CORP. CODE §§ 17000-17705.

2 The Business Law Section of the State Bar of California published the Partnerships Report as part of the Business Law News, Volume XX, Issue 1 (Winter 1999).

3 The Business Law Section of the State Bar of California has also issued a report on personal property secured transactions entitled *Report Regarding Legal Opinions in Personal Property Secured Transactions (December 1988)*. In addition, the Real Property Law Section of the State Bar of California (together with the Real Property Section of the Los Angeles County Bar Association) has issued a report on real estate transactions entitled *Legal Opinions in California Real Estate Transactions and Legal Opinions in California Real Estate Transactions: An Addendum (March 14, 1990)*. The Business Law Section has republished these reports and the Corporations Report in a pamphlet entitled *1990 California Opinion Reports*. See also the *1995 California Real Property Legal Opinion Report,* a Report of a Joint Committee of the Real Property Section of the State of California and the Real Property Section of the Los Angeles County Bar Association on the Legal Opinion Reports of (I) the ABA Section of Business Law, and (II) the ABA Section of Real Property, Probate and Trust Law and the American College of Real Estate Lawyers, 13 Cal. Real Prop. J. 1, (Fall, 1995).

4 See Partnerships Report § III.A.2.

5 See Corporations Report §§ V.A.1 and V.A.2.

6 See Partnerships Report § III.A,2.

7 The California Revised Limited Partnership Act is codified in CAL. CORP. CODE §§ 15611-15800.

8 CAL. CORP. CODE § 17050(a). It should be noted that, under the LLC Act, a written operating agreement need not be entered into by the members of the limited liability company. The LLC Act functions as a default statute, imputing the provisions of the LLC Act to issues and matters not otherwise addressed by the members.

9 CAL. CORP. CODE § 17050(c).

10 See Partnerships Report § III.A.2.

11 See Corporations Report §§ V.A.1 and V.A.2.

12 CAL. CORP. CODE § 17354.

13 Also note that the LLC Act provides a limited liability company the opportunity to file a certificate of continuation under certain circumstances, including upon the unanimous vote of remaining members to continue the business of the limited liability company, in which event the prior filing of a certificate of dissolution is deemed to be of no force or effect. CAL. CORP. CODE § 17357.

14 Dissolution does result in significant restrictions on the activities in which a limited liability may engage. Because dissolution may affect the power and authority of the limited liability company to conduct its business or to enter into the transaction that is the basis for the opinion, it is an important issue in connection with the power and authority of the limited liability company, which is normally the subject of a separate opinion.

15 CAL. CORP. CODE §§ 17050(a); 17001(ab).

16 CAL. CORP. CODE § 17050(c).

17 See Corporations Report § V.A.3.

18 See Corporations Report § V.A.4.

19 CAL. CORP. CODE § 17356(b).

20 CAL. REV. AND TAX. CODE §§ 23091 and 23092.

21 CAL. REV. AND TAX. CODE § 23095; CAL. CORP. CODE § 17375(b)(5).

22 Pursuant to CAL. CORP. CODE § 17060, limited liability companies are required to file biennial statements setting forth, among other things, the name and address of all managers (or if there are no managers, the names and addresses of all members) and a description of the limited liability company's principal business activities. Although such information may be useful to counsel rendering an opinion regarding the limited liability company, it is not customary for counsel to obtain and review such statements, or equivalent statements filed by corporations or limited partnerships, as a part of counsel's routine due diligence. This practice is supported by the provisions of CAL. CORP. CODE § 17060(f) which states that "[this] section shall not be construed to place any person dealing with the limited liability company on notice of, or under any duty to inquire about, the existence or content of a statement filed pursuant to this section."

23 Although operating agreements are not required to be in writing (CAL. CORP. CODE § 17001(AB)), counsel ordinarily may be hesitant to render an opinion regarding a limited liability company that is governed by an oral agreement in light of the inherent difficulty in ascertaining all of the terms of the agreement of the members. In any event, as a matter of professional responsibility to the client, counsel typically will urge the members to put their agreement in writing.

24 Counsel, however, often may be asked to independently render an opinion regarding the status of such managers, members or officers, especially if they are executing the transaction documents on behalf of the limited liability company.

25 CAL. CORP. CODE § 1705 1 (a)(b).

26 CAL. CORP. CODE § 17451. Section 17001(ap) of the LLC Act defines the term "transact intrastate business" to mean entering into repeated and successive transactions of business in California, other than in interstate or foreign commerce. The definition lists various activities that, standing alone, will not constitute the transaction of intrastate business.

27 CAL. CORP. CODE §§ 17456(a) and (b).

28 As will be discussed, the LLC Act prohibits limited liability companies from operating in the banking, insurance and trust company businesses and limits their ability to render professional services. The power-to-conduct-business opinion does address these limitations, as discussed below.

29 See discussion in § C below.

30 Corporations Report, §V.B.1; Partnerships Report, § V.B.1.

31 CAL. CORP. CODE § 206.

32 CAL. CORP. CODE § 15616.

33 CAL. CORP. CODE § 17002.

34 Lenders in certain "conduit" real estate secured or other secured financing increasingly require a corporation's articles of incorporation to include various special purpose provisions for bankruptcy remoteness purposes placing limits on the business that the corporation may engage in and on the assets that it may own. Such lenders similarly may require a limited liability company's articles of organization to contain equivalent restrictions.

35 CAL. CORP. CODE § 17051(c)(3) requires that the articles state that "[t]he purpose of the limited liability company is to engage in any lawful act for which a limited liability company may be formed under the [LLC Act]."

36 CAL. CORP. CODE § 202(b) (West 1998).

37 However, the form Form LLC-l articles of organization for limited liability companies, promulgated by the California Department of State, allows the organizer to append additional provisions. See CAL. CORP. CODE § 17051 (c)(1). In addition, as noted in footnote 35, in many real estate or other secured financing transactions, lenders require that restrictions be placed in the articles of organization limiting the purposes and powers in order to create so-called "single-purpose entities" for various reasons including bankruptcy remoteness.

38 See, however, the discussion below regarding professional services rendered by a limited liability company.

39 Partnerships Report § V.B.1.

40 ln this case, certified by one or more managers or members as being true and complete, rather than certified by the Secretary of State.

41 For a discussion of the use of express and implicit assumptions in opinion letters, see Accord §§ 4 and 5, TriBar II Report §2.3.

42 An opinion recipient who desires an opinion regarding the entity power and authority of a manager or member to act on behalf of the limited liability company should expressly request such an opinion.

43 CAL. CORP. CODE § 17354.

44 Alternatively, as described in Section C below, there may be many instances where the opinion recipient may accept a more limited opinion to the effect that the limited liability company has the power and authority to enter into and perform the applicable agreement or execute the applicable transaction documents. If so, counsel will need to verify that these particular actions are not in conflict with Section 17375, but should not be required to examine whether unrelated activities of the limited liability company constitute professional services for purposes of Section 17375.

45 Corporations Report, § V.B.2; Partnerships Report, § V.C.

46 Id.

47 Note that this element varies from that of the power-to-conduct-business opinion and considerably lessens the burden of the opinion giver regarding the implications of Section 17375 of the LLC Act. In order to confirm compliance with the provisions of Section 17375 for purposes of a power-to-enter-into-the-agreement opinion, counsel only needs to verify that the transaction and each of its components do not encompass the rendering of professional services. For example, if an opinion is requested to support a limited liability company's obtaining a real estate secured loan, the fact that the company may be engaged in professional services unrelated to its power and authority to borrow money and pledge its assets would be outside the scope of the power-to-enter-into the agreement opinion. It is the consensus of the Committee that this meets the reasonable expectations of counselor any party to a transaction requesting an opinion that the limited liability company has the power to enter into the subject transaction (as opposed to the power to conduct the business in which it is engaged).

48 CAL. CORP. CODE § 17354.

49 In this case, certified by one or more of the members or managers as being true and complete, rather than certified by the Secretary of State.

50 For a discussion of what constitutes unfinished business with respect to a partnership, see Grossman v. Davis, 28 Cal.App.4th 1833; 34 Cal.Rptr.2d 355 (1994).

51 For a discussion of the use of express and implicit assumptions in opinion letters, see Corporations Report pp. 17-19, Accord §4, TriBar II Report §2.3.

52 CAL. CORP. CODE § 17551 provides that a merger requires the unanimous consent of members if the members are to become personally liable for any obligations of the surviving entity as a result of the merger, unless the members are provided dissenters' rights in accordance with the LLC Act (CAL. CORP. CODE §§ 17600, et seq.).

53 CAL. CORP. CODE § 17001(v).

54 See CAL CORP.CODE § 17156.

55 In general, see Corporations Report § IV.D.3. regarding the use of back-up certificates.

56 See CAL. FAM. CODE § 11000.

APPENDIX A

SELECTED CASES CONCERNING LEGAL OPINIONS

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APPENDIX B

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